

Trust 6 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State =

Dear :

This responds to a letter dated July 10, 2015, and supplemental information, submitted on behalf of X, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code (the Code).

#### FACTS

According to the information submitted, X was incorporated on Date 1, under the laws of State. Effective Date 2, X elected to be taxed as an S corporation. Effective Date 3, X elected to treat both Y and Z as a Qualified Subchapter S Subsidiary (QSub).

On Date 4, A, a shareholder of X, died. Pursuant to A's will, A's X shares were transferred to Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 and Trust 6. Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 and Trust 6 are collectively referred to as the Trusts. The Trusts were eligible shareholders of X until Date 5.

As of Date 5, the Trusts were intended to be treated as qualified subchapter S trusts (QSSTs), however, none of the income beneficiaries of Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 or Trust 6 filed a timely QSST election for their respective trust, therefore causing X's S corporation election to terminate as of Date 5.

X represents that the Trusts qualified as QSSTs under § 1361(d) as of Date 5 and thereafter. X further represents that the circumstances resulting in the failure to file QSST elections for the Trusts were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X further represents that X has filed its income tax return consistent with having a valid S election in effect for all taxable years since X elected to be an S corporation. X and its shareholders have agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required

by the Secretary.

## LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that, for purposes of section 1361(b)(1), a trust all of which is treated (under subpart E of part I of subchapter J) as owned by an individual who is a citizen or resident of the United States may be an S corporation shareholder.

Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1362(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST’s beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST’s S corporation stock to which the election under § 1361(d)(2) applies. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means a trust (A) the terms of which require that – (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1361(d)(4)(B) provides that if any QSST ceases to meet the requirement of § 1361(d)(3)(B), but continues to meet the requirements of § 1361(d)(3)(A), the provisions of § 1361(d) shall not apply to the trust as of the first day of the first taxable year

beginning after the first taxable year for which the trust failed to meet the requirements of § 1361(d)(3)(B).

Section 1.1361-1(j)(6)(iii)(c) provides that, in the case of a QSST election, if a trust ceases to be a qualified Subpart E trust, satisfies the requirements of a QSST, and intends to become a QSST, the QSST election must be filed within the 16-day-and-2-month period beginning on the date on which the trust ceases to be a qualified subpart E trust.

Section 1362(a) provides, in part, that a small business corporation may elect to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides in part that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period of inadvertent termination of the S election, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations, provides that the current income beneficiary of the trust must make the election by signing and filing with the service center with which the corporation files its income tax the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1.1361-1(j)(6)(iii)(A) provides that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1.1361-1(j)(6)(iii)(E) provides that if a corporation's S election terminates because of a late QSST election, the corporation may request inadvertent termination relief under § 1362(f).

Section 1.1361-1(j)(7)(i) provides that the income beneficiary who makes the QSST election and is treated (for purposes of § 678(a)) as the owner of that portion of the trust that consists of S corporation stock is treated as the shareholder for purposes of §§ 1361(b)(1), 1366, 1367, and 1368.

Section 1.1362-4(b) provides, in relevant part, that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination of the election was inadvertent.

Section 1.1362-4(f) provides, in relevant part, that the status of the corporation after the terminating event and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination relief may be granted retroactively for all years for which the terminating event is effective, in which case the corporation is treated as if its election had not terminated.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S corporation election terminated on Date 5 as a result of the failure to make a timely QSST election for Trust. We further conclude that the termination of X's S election on Date 5 was inadvertent within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation as of Date 5 and thereafter, provided that the beneficiary of Trust 1, Trust 2, Trust 3, Trust 4, Trust 5 and Trust 6 each files a QSST election for their respective trust with an effective date of Date 5 with the appropriate service center within 120 days from the date of this letter, and X's S corporation election is not otherwise terminated under § 1362(d). A copy of this letter must be attached to the QSST election.

Furthermore, Y and Z will be treated as QSubs effective Date 5 and thereafter, provided Y and Z otherwise are eligible to be treated as QSubs.

Except as specifically ruled upon above, we express or imply no opinion concerning the

federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation. Further, no opinion is expressed or implied concerning whether Trust meets the requirements of a QSST under § 1361(d)(3). In addition, we express or imply no opinion concerning whether Y or Z are eligible to be QSubs.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to the taxpayer's authorized representative.

Sincerely,

*David R. Haglund*

David R. Haglund  
Branch Chief, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy of this letter for section 6110 purposes

cc: